

Report for the revision of “Fiscal Monetary Services and Inflation”

Summary

The paper has been improved. There are still many concerns which are all related to my previous comments.

Comments

1. There is still a gap between the theory and empirical parts. As mentioned before, the conducts of monetary and fiscal policy and the associated private expectations are crucial to determine liquidity/bubble aspect of government issued assets. After reading a few times, I am still not sure what the measures (though conceptually very interesting) are. Take the simple partial-equilibrium model as the example, I understand you may not want to think government policy at this stage, but shouldn't you specify the exogenous path of primary surplus or deficit and many others? In the simplest way of thinking the problem (I know the paper has rich ingredients), one wants to compute the product of the quantity of an asset and the spread between the relevant interest rate if the asset does not have moneyness (e.g., holding till the maturity date) and its observed market interest rate. The tricky “relevant” interest rate then depends on many things and especially expectations. At least, the path of primary surplus or deficit is crucial, but I don't see a clear discussion of that.

Of course, one can put theoretical restrictions such as those provided by a certain model with monetary-fiscal interactions. By the paper does not try to estimate the monetary service of treasury assets under those assumptions. Given the importance of growth-rate estimation (see Figure 5), the model should also incorporate growth; one can then look at the growth rate of the model and the growth rate of the data, or detrend the data and the model in the same way. But these exercises are not in the paper, leaving me puzzled what the measures are really about.

2. I want to further explain the point of interest rate below growth rate. I am happy to see that the author considers low interest rate on short-term bonds, but I don't think it is sufficient to address the concern of the general problem of bubbles on government debt. The key insight from that literature is that you either have multiple equilibria (not surprising at all given bubbles, but there is some subtle insight on the selection of inflation such as the lower bound) or you need to have very specific (off-equilibrium) tax policy to rule out the multiplicity. The recent version of Brunnermeier, Merkel, and Sannikov (2020) actually use an Obstfeld-Rogoff (1983) style policy to illustrate that. Therefore, a low interest rate (or a negative interest rate in a stationary environment) will have strong implications on the debt Laffer curve so debt supply will become important, or it will have strong implications on the tax policy, which goes back to my point 1 above.

3. The discussion of safety and liquidity premium in Appendix E.3 does not answer my previous question. The author considers the spread between the rate of 90-day AA non-financial commercial paper (non-secured credit) and the rate of 90-day AA asset-backed commercial paper. But my previous question was about the usefulness of Treasury debt itself used as collateral compared to others (note: Treasury debt is widely used as collateral with its haircut close to 0 while Aaa assets can have 50% haircut). Finding a way to decomposing spread to safety and liquidity premia (e.g., using Baa assets and Treasury debt, but the author has potentially better ways) and analyzing their relationship in the paper's framework can significantly level up the analysis.